No.

OFFICE OF THE CLERK

In The

Supreme Court of the United States

October Term, 1993

JAMES W. BURKE, as Personal Representative of the ESTATE OF EDNA SPROULL WILLIAMS, Deceased,

Petitioner,

vs.

THE UNITED STATES,

Respondent.

Petition for Writ of Certiorari to the United States Court of Appeals for the Federal Circuit

PETITION FOR WRIT OF CERTIORARI

WILLIAM R. FRAZIER
Counsel of Record
FRAZIER & FRAZIER
Attorneys for Petitioner
1515 Riverside Avenue
Suite A
Jacksonville, Florida 32204
(904) 353-5616

1705
Lutz Appellate Services, inc.
(800) 3 APPEAL • (800) 5 APPEAL • (800) BRIEF 21

'16 pd

QUESTION PRESENTED

Whether or not a charitable deduction for federal estate tax purposes, allowed by § 2055(a) of the Internal Revenue Code must be reduced by the amount of certain administrative expenses paid by the decedent's personal representative from post-mortem income, notwithstanding the fact that the estate tax charitable deduction claimed on the estate's estate tax return, Form 706, in the amount of $8,869,080.10, in a situation wherein the charitable institution actually received assets of the estate in payment of the charitable bequest, in excess of $10,091,707.94.

The administrative expenses in question amounted to the sum of $144,441.

The Commissioner of Internal Revenue in auditing the estate's federal estate tax return determined that the charitable bequest should be reduced by the amount of the administrative expenses although paid from post mortem income, plus estate taxes attributable thereto or a reduction in the estate's charitable deduction as claimed of $288,258.94. The action of the Commissioner, resulted in an estate tax deficiency in the amount of $80,110.87, plus accrued interest in the amount of $30,606.13, or a total liability of $110,717.00, which gave rise to this litigation.

PARTIES TO THE PROCEEDING

The full names of every party or the names of all parties to this case appear in the caption of the case.

TABLE OF CONTENTS

	Page
Question Presented	i
Parties to the Proceeding	ii
Table of Contents	iii
Table of Citations	iii
Opinions Below	1
Grounds of Jurisdiction	2
Statute Involved	2
Statement of the Case	2
Statement of Jurisdiction	9
Reasons for Granting the Writ	9
Conclusion	16

TABLE OF CITATIONS

Cases Cited:

Estate of Dorothy J. Warren, Dec. v. Commissioner of Internal Revenue, 981 F.2d 776 (5th Cir. 1993) 9, 10, 11

Estate of Edward H. Luehrmann v. Commissioner, 287 F.2d 10 (8th Cir. 1961) 12

Contents

Page

Estate of Gordon P. Street v. Commissioner, T.C. Memo 1988-553, 56 TCM 774 (1988) 14, 15

Estate of Harry E. Wright, Jr. v. United States, 677 F.2d 53 (9th Cir. 1982) 13

Estate of Walter E. Richardson v. Commissioner, 89 T.C. 1193 (1987) 14

Harrison v. Northern Trust Co., et al., 317 U.S. 476 (1943) 11, 12, 13

Heim v. Nee, 40 F. Supp. 594 (W.D. Mo. 1937) 12

In Re: Sage's Estate, 122 F.2d 480 (3rd Cir. 1941) 13

William J. Oetting, Exec. v. United States, 712 F.2d 358 (8th Cir. 1983) 13

Statutes Cited:

28 U.S.C. § 1254 2

28 U.S.C. § 1295(a)(3) 9

28 U.S.C. § 1491 9

Internal Revenue Code:

§ 501(c)(3) 3

Contents

	Page
§ 2053	6
§ 2054	6
§ 2055	11, 13, 15
§ 2055(a)	i, 2
§ 2056	13
§ 2056(a)	14, 15

Other Authority Cited:

Treasury Regulations § 1.642(g)-1	6

APPENDIX

Appendix A — Judgment of the United States Court of Appeals for the Federal Circuit Dated June 2, 1993 ... 1a

Appendix B — Opinion of the United States Court of Appeals for the Federal Circuit Dated June 2, 1993 ... 3a

Appendix C — Opinion of the United States Court of Appeals for the Federal Circuit Dated June 2, 1993 ... 18a

Appendix D — Decision of the United States Court of Appeals for the Fifth Circuit in the Case of *Estate of Dorothy J. Warren, Deceased, et al. v. Commissioner of Internal Revenue* Dated January 13, 1993 ..... 20a

Contents

Page

Appendix E — Judgment of the United States Claims Court Filed November 29, 1991 ..... 40a

Appendix F — Order of the United States Claims Court Filed November 27, 1991 ..... 41a

Appendix G — Internal Revenue Code Section 2055(a) .. 52a

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Petitioner,

vs.

THE UNITED STATES,

Respondent.

Petition for Writ of Certiorari to the United States Court of Appeals for the Federal Circuit

PETITION FOR WRIT OF CERTIORARI

Petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Federal Circuit entered in the above-entitled cause on June 2, 1993.

OPINIONS BELOW

The opinion of the United States Claims Court in Docket No. 540-89T entered November 27, 1991, is not officially reported and a copy of the Claims Court opinion is reproduced in Appendix F, *infra* p. 41a.

The opinion of the United States Court of Appeals for the Federal Circuit in Docket No. 92-5062 entered June 2, 1993, is likewise not officially reported and a copy of the Court of Appeals opinion is reproduced as Appendix B, *infra* p. 3a.

GROUNDS OF JURISDICTION

(i) The judgment of the United States Court of Appeals for the Federal Circuit sought to be reviewed herein was entered on June 2, 1993 (Appendix A, *infra* p. 1a).

(ii) There was no motion filed in the case for a rehearing, and no application for extension of time within which to file the petition for writ of certiorari was filed.

(iii) The statutory provision believed to confer on this Court jurisdiction and review judgment by writ of certiorari is Title 28 U.S.C. § 1254.

STATUTE INVOLVED

The statutory provision involved is § 2055(a) of the Internal Revenue Code which is set forth in Appendix G, *infra* p. 52a .

STATEMENT OF THE CASE

Edna Sproull Williams died testate on February 28, 1982, while a resident of Jacksonville, Florida.

The decedent died testate leaving a Will dated October 9, 1979, and a Codicil thereto dated October 30, 1979.

Decedent's Will and Codicil were filed for probate in the Circuit Court for Duval County, Florida, on March 2, 1982.

James W. Burke, the petitioner in this case, is the surviving and presently acting Personal Representative of the decedent's estate.

The Edna Sproull Williams Foundation was created during decedent's lifetime pursuant to the terms of a charitable trust agreement dated February 13, 1976, and is an organization exempt from taxation under § 501(c)(3) of the Internal Revenue Code.

Article I of the decedent's Will provided in part as follows:

> . . . I direct that all estate, inheritance, and succession taxes that may be levied against my estate, including such taxes levied against property constituting any part of my estate for federal estate tax purposes, whether passing under this Will or otherwise, shall be paid by my Personal Representatives, solely out of the residuary estate being bequeathed hereunder, it being my intention that the portion of my estate devised and bequeathed to or for the benefit of all legatees hereunder, except the residuary legatee, shall be enjoyed by them free from any burden from such taxes . . . .

The decedent bequeathed her residuary estate under Article XIII of her Will providing in part:

> I give, devise and bequeath all the rest, residue and remainder of my estate, including all lapsed legacies or devises, after paying therefrom any debts and taxes, including estate, inheritance, or succession taxes and other obligations of my estate, including all administrative expenses, to the Trustees of the

> Edna Sproull Williams Foundation which I established under a Trust Agreement dated February 13, 1976 . . . .

The Personal Representatives of the decedent's estate filed the estate's United States Estate Tax Return, Form 706, dated November 24, 1982, within the time and manner prescribed by law.

An amended United States estate tax return dated February 21, 1983, was filed, for the purpose of correcting the calculation of the credit for State death taxes.

On November 11, 1982, and prior to the filing of the federal estate tax return, the Personal Representatives of the decedent's estate filed a petition for construction of the decedent's Will in the Circuit Court for Duval County, Florida, seeking a construction of Article I and Article XIII of the decedent's Will, and the entry of an order of court authorizing the petitioners as personal representatives of the decedent's estate to pay administrative expenses out of the income earned over a period of years while the estate remained open, rather than paying these expenses out of and as a charge against the principal of the decedent's residuary estate.

In the petition for construction of the Will, the petitioners pointed out to the court that under Article I of the Will there was a direction that all estate taxes were to be paid by the Personal Representatives solely out of the residuary estate, but that Article I gave no specific directions with regard to payment of administrative expenses.

The petition for construction of Will also called the attention of the court to Article XIII of the decedent's Will that provided for the bequest of her residuary estate to the Edna Sproull Williams Foundation after the payment therefrom of any debts and taxes, including estate taxes and other obligations of the estate, including all administrative expenses.

The petitioners also pointed out to the court that while Article I of the Will mandated that estate taxes be paid out of the residuary estate, Article XIII implied no such mandate with respect to administrative expenses, and petitioners urged the court to interpret this portion of the decedent's Will to mean that such expenses may be paid out of such residuary estate, at the discretion of the Personal Representatives, if not paid out of income. Petitioners further pointed out that if decedent had intended administrative expenses to be paid out of the residuary estate as an absolute requirement, administrative expenses would have been included with estate taxes as mandated by Article I of the Will.

The court entered its order pursuant to the petition on November 12, 1982, in which it was ordered as follows:

> Articles I and XIII of the decedent's Will are construed to authorize payment of the administrative expenses by the Personal Representatives out of income if they choose to pay such expenses out of income, and to the extent that the Personal Representatives do not choose to pay administrative expenses out of income, such administrative expenses shall be paid out of the residuary share of the estate prior to distribution to the residual beneficiary, as requested in the Petition.

The Personal Representatives, in filing the estate tax return (Form 706), did not take a deduction for any of the estate's administrative expenses.

The Personal Representatives, in filing the first fiduciary income tax return for the decedent's estate covering the period March 1, 1982, through December 31, 1982, deducted administrative expenses totalling $144,441 consisting of fiduciary

fees of $75,000, attorneys' and accountants' fees $51,765, and other miscellaneous administrative deductions totalling $17,676.

At the time the fiduciary income tax return was filed, the Personal Representatives filed the elective statement required by the Treasury Regulations § 1.642(g)-1 in which the estate waived the right to deduct these administrative expenses as deductions from the decedent's gross estate for estate tax purposes under §§ 2053 or 2054 of the Internal Revenue Code.

The decedent's estate tax return shows a total gross estate of $10,489,753.94, from which total allowable deductions were taken of $9,747,444.42, leaving a taxable estate of $742,309.52.

The return further disclosed that of the total deductions claimed of $9,747,444.42, $9,662,605.10 represented deductions for charitable bequests of which $8,869,080.10 represented the residual bequest made by the decedent's Will to the Trustees of the Edna Sproull Williams Foundation.

The Commissioner in auditing the federal estate tax return determined that the administrative expenses in the amount of $144,441 which had been claimed as expenses on the estate's fiduciary income tax return, Form 1041, reduced the amount of the charitable bequest made to the Foundation.

The Commissioner actually reduced the amount of the charitable deduction resulting from the gift to the Foundation by $236,536.38 which was represented by the $144,441 of administrative expenses and the estate taxes attributable thereto, with the result that the Commissioner assessed a deficiency in estate tax against the decedent's estate of $80,110.87.

The Personal Representatives paid the deficiency in the amount of $80,110.87, plus interest in the amount of $30,606.13, in full under protest on or about July 9, 1985.

Within the time and manner prescribed by law, the Personal Representatives filed a claim for refund, Treasury Form 843, seeking a refund of the $80,110.87 deficiency, plus the interest paid, which claim was disallowed on October 7, 1987. Petitioner filed his complaint in the United States Court of Claims on October 4, 1989 (petitioner's complaint and copy of Treasury Form 843 attached thereto, and respondent's answer, paragraph 13, page 2).

The $144,441 of administrative expenses in question were paid during the calendar year 1982 by the Personal Representatives of the decedent's estate solely from the income accumulated during the first ten months of the estate's administration and from no other source.

During the first ten months of the administration of the decedent's estate ending December 31, 1982, the total income from all sources amounted to $434,514.78 and that expenses were disbursed from this income, including the $144,441 in question in this case which left net accumulated income of the estate as of December 31, 1982 of $288,258.94.

Distributions of assets and property were made from the estate of Edna Sproull Williams, deceased, to the Trustees of the Edna Sproull Williams Foundation from the inception of the administration of the decedent's estate through December 31, 1989, as follows:

Year	Amount
1982	$ 696,924.18
1983	5,043,338.74
1984	531,686.48
1985	619,758.54
1986	600,000.00
1987	1,900,000.00

Year	Amount
1988	-0-
1989	700,000.00
Total:	$ 10,091,707.94

to which was added $312,316.99 unrealized appreciation on securities at date of transfer and $151,268.35 of accrued interest at date of transfer, resulting in total value of assets transferred to the Foundation during said period of $10,555,293.28.

The case was heard before the United States Claims Court on Motions and Cross-Motions for Summary Judgment filed by the parties together with supporting exhibits, affidavits, etc., therefore, no trial or hearing was held before the Trial Court.

The Trial Court upheld the Commissioner's determination and entered a final judgment in this case on November 29, 1991.

The Trial Court held that under the Florida Statute and under the terms of the decedent's Will the administrative costs in question were to be charged against the principal of the estate. The Court therefore concluded that this reduced the amount of the residue to be received by the charitable foundation under the terms of the decedent's Will. Therefore the Court held that the estate's charitable deduction must be reduced by the amount of these administrative expenses.

For obvious reasons, we believe this conclusion erroneous, as a matter of law.

Following the entry of the Trial Court's final judgment in this case a notice of appeal was filed and appeal taken and prosecuted before the United States Court of Appeals for the Federal Circuit.

The Court of Appeals upheld the decision of the Trial Court. The Appeals Court entered a final judgment in this case on June 2, 1993. This petition was filed within the ninety day period prescribed by Rule 13 of the Rules of the Supreme Court.

STATEMENT OF JURISDICTION

(a) The statutory basis for jurisdiction of the Trial Court (United States Claims Court) is Title 28 U.S.C. § 1491.

(b) The statutory basis for jurisdiction of the United States Court of Appeals for the Federal Circuit, hearing the appeal from the adverse decision of the Trial Court is Title 28 U.S.C. § 1295(a)(3).

REASONS FOR GRANTING THE WRIT

1. The decision of the United States Court of Appeals for the Federal Circuit is in direct conflict with the recent decision of the United States Court of Appeals for the Fifth Circuit in *Estate of Dorothy J. Warren, Dec. v. Commissioner of Internal Revenue*, 981 F.2d 776 (5th Cir. 1993) (Appendix D, *infra* p. 20a), reversing and remanding the decision of the United States Tax Court, T.C. Memo 1990-377, 60 TCM 206 (1990). The Court of Appeals for the Fifth Circuit held in a similar estate tax deduction case, involving charitable transfers, that 72 1/2 percent of the expenses that were charged to the estates post mortem income did not reduce the amount of the estate's charitable deduction for federal estate tax purposes. The court so held although the decedent's Will provided that all administrative expenses were to be paid from the residuary estate. The court further held that the state court decree was binding and that the estate tax charitable deduction must be computed on the basis of what the charities received under the Will pursuant to the state court decree.

In the *Warren* case, the Commissioner of Internal Revenue contended and the Tax Court agreed that the will required that all administrative expenses be charged to the residuary corpus before computing " . . . the initial net fair market value of the assets constituting the trust."

2. The Court of Appeals for the Federal Circuit, toward the end of its opinion, seems to agree that the *Warren* case is in conflict with their opinion in this case, as it relates to the issue of reducing the charitable deduction by the amount of administrative expenses paid from post-mortem income wherein it stated "Even if the decision in Warren were applicable to the present case we would decline to follow it." (Appendix D, *infra* p. 20a).

3. The decision of the Court of Appeals for the Federal Circuit is also in conflict with that part of the holding in the *Warren* case which expressly held that "The estate tax charitable deduction should be computed on the basis of what the charities will receive under Article V of the will pursuant to the probate court's judgment." In this connection, the record in this case shows that the charitable deduction claimed on the estate's federal estate tax return (Form 706) amounted to the sum of $8,869,080.10, and that the charity actually received distributions from the personal representative of the estate greatly in excess of the amount claimed, totalling $10,091,707.94. Therefore assets of the decedent's residuary estate have passed to the charity in an amount not less than $8,869,080.10, the amount of the charitable deduction claimed, as authorized by § 2055 of the Code, and that the decision in the instant case is in irreconcilable conflict on this point, with that of the Fifth Circuit in the *Warren* case.

4. The petitioner therefore respectfully suggests to the Court that the decision of the United States Court of Appeals for the Federal Circuit is therefore in conflict with the two very important points covered by the Fifth Circuit in the *Warren* case, namely:

(a) that administrative expenses paid by an estate from post-mortem income do not reduce the amount of the estate's corpus passing to charities where a residuary bequest is made, and that § 2055 allows the deduction for charitable purposes undiminished by the payment of the administrative expenses in this context; and

(b) that the charitable deduction under § 2055 should be computed and based upon the actual amounts received by the charity pursuant to the terms of the decedent's Will and any relevant probate court orders that may have been issued, during the course of the administration of the decedent's estate.

On both scores the decision in the instant case is in conflict with that of the Fifth Circuit in the *Warren* case. We urge the Court to grant this petition in order to resolve these obvious conflicts between the circuits.

If the Court permits this decision to stand then taxpayers within the jurisdiction of the United States Court of Appeals for the Fifth Circuit in the States of Texas and Louisiana will receive entirely different tax treatment than those who are subject to the jurisdiction of the United States Court of Appeals for the Federal Circuit and the United States Claims Court, in cases involving the identical issue.

5. The decision of the Court of Appeals is also in conflict with several other decisions which have held that the amount of the charitable deduction for federal estate tax purposes under § 2055 and predecessor sections of the Code should be computed on the basis of what the charities actually receive under the terms of the decedent's Will and any state statutes or probate court orders as follows:

(a) The decision of this Court in *Harrison v. Northern Trust Co., et al.*, 317 U.S. 476 (1943), wherein the Court stated in a

similar estate tax charitable deduction case that ". . . the amount to be deducted from decedent's gross estate on account of the bequest of his residuary estate to charity is the actual amount of such bequest, after payment of federal estate taxes, or what would have been the amount if there been no such taxes." In the instant case the actual amount of the residuary estate passing to the Foundation was equal to and not less than the exact amount claimed as a charitable deduction on the return of $8,869,080.10, since the controversial administrative expenses were not paid from the corpus of the decedent's residuary estate, but instead were paid from the accumulated post-mortem income realized from the administration of the estate.

(i) The United States Court of Appeals for the Eighth Circuit in *Estate of Edward H. Luehrmann v. Commissioner,* 287 F.2d 10 (8th Cir. 1961) in commenting on the Court's decision in *Harrison v. Northern Trust Co., et al.* stated "While Northern Trust dealt with the deduction of inheritance taxes in determining the value of the charitable bequest, we believe that it does clearly indicate a view on the part of the Court that the charitable deduction allowed by § 812(d) shall not exceed the amount of the residue passing to the charitable beneficiaries."

The petitioners in *Luehrmann* had argued that *Northern Trust* dealt only with the deduction of estate taxes and that since the deduction involved in their case pertains to administrative expenses rather than estate taxes that their factual situation did not fall within the coverage of the amendment. The court in *Luehrmann* stated further "A number of courts have taken the position that in instances where a charity compromises or settles an adverse claim to the charitable devise or bequest, only the amount actually received by the charity is available as a charitable deduction." Citing the decision in *Heim v. Nee*, 40 F. Supp. 594, 595 (W.D. Mo. 1937), wherein Judge Otis states: "The amount to be deducted for testamentary charitable gifts must be computed on

the basis of what the charities actually receive, not on the basis of what is provided in the will of the decedent." As repeatedly set forth in this petition, the charitable foundation received assets from the decedent's estate in excess of the amount claimed as a charitable deduction on the estate's estate tax return, and therefore under the authority of *Northern Trust* and related decisions, the deduction should be allowed as claimed.

(b) The decision in this case is also in conflict with the *Estate of Harry E. Wright, Jr. v. United States,* 677 F.2d 53 (9th Cir. 1982) which held in an estate tax charitable deduction case that "The paramount concern, for federal tax purposes, is with the real distribution of the funds rather than their nominal source" and the court continued "[t]he amount to be deducted for charitable gifts must be computed on the basis of what the charities actually received, not on the basis of what is provided in the will" citing *In Re: Sage's Estate,* 122 F.2d 480, 484 (3rd Cir. 1941).

(c) The decision in this case is also in conflict with a decision of the United States Court of Appeals for the Eighth Circuit in *William J. Oetting, Exec. v. United States,* 712 F.2d 358 (8th Cir. 1983) which held that in an estate tax charitable deduction case arising under § 2055 of the Code "A deduction is claimed only for those amounts that were actually received by the four charities. The deduction should be allowed." Here again, the Eighth Circuit is emphasizing that the amount allowable as a charitable deduction under § 2055 is to be computed on the amount that the charity or charities actually received. In this case the charitable foundation actually received principal from the decedent's residuary estate having a market value and an amount not less than the amount claimed as a charitable deduction on the federal estate tax return, in the amount of $8,869,080.10.

6. The issue in this case has also arisen in the marital deduction area of federal estate taxes, provided by § 2056 of the Internal

Revenue Code. Frequently the cases arise under substantially identical circumstances to the instant case, in situations where residual marital bequests are made and administrative expenses, instead of being paid from the principal of the estate, are paid from post-mortem income accumulations. The issue raised is identical as to whether or not the claimed marital deduction must be reduced by the amount of the administrative expenses or whether it should be allowed undiminished by the payment of administrative expenses, from accumulated post-mortem income.

Two recent decisions of the Tax Court involving this question in the marital deduction field are in the *Estate of Walter E. Richardson v. Commissioner,* 89 T.C. 1193 (1987) and in the *Estate of Gordon P. Street v. Commissioner,* T.C. Memo 1988-553, 56 TCM 774 (1988).

The Tax Court in *Richardson* held that certain estimated interest payments on federal estate taxes and state inheritance taxes, and on deficiencies with regard to said taxes is chargeable to the *income* of the estate, and did *not* reduce the amount of the marital deduction to the estate allowable under § 2056(a) of the Code.

The Tax Court in this connection stated in part:

> The principal issue remaining for decision is whether interest payable by petitioners on federal estate taxes and State inheritance taxes and on deficiencies with regard to such taxes, is chargeable against the principal of the estate or the income produced by the principal. *If the interest is chargeable against income, it will not reduce the value of the interest in the estate that will pass to the surviving spouse under the Will and consequently will not reduce the amount of the marital deduction.*

In the *Street* case, the Tax Court, speaking through Judge Tannewald, held that the expenses of administration and interest payable on State inheritance and federal estate taxes were payable from the income of the estate, and thus did not reduce the amount of the principal eligible for the estate tax marital deduction.

The Tax Court, in part, stated:

> The primary issue for decision is whether administrative expenses and interest payable on State inheritance taxes, federal estate taxes, and deficiencies related thereto, are chargeable to the principal of the estate or to the income generated therefrom. If they are chargeable to the income, they do not reduce the amount of the principal passing to the surviving spouse, and hence qualify for the marital deduction.

Unfortunately, from the taxpayer's standpoint, the decision of the Tax Court in *Street* was partially reversed and partially affirmed by the decision of the Sixth Circuit, 974 F.2d 723 (6th Cir. 1992).

We call these Tax Court decisions to the attention of the Court for the sole purpose of showing the frequency with which the question involved in this case arises and also the fact that the issue not only involves the computation of the charitable deduction for federal estate taxes under § 2055, but also the marital deduction prescribed by § 2056(a).

7. We urge the Court to grant this writ, even though the issue involved in this case is not of earth-shaking consequences. The issue, however, has been repeatedly raised before the lower federal courts for many years, and currently rises primarily in the area involving determining the amount of a charitable deduction

allowable for federal estate tax purposes and the amount of the allowable marital deduction for federal estate tax purposes. These courts include the United States Tax Court, U.S. District Courts, Court of Claims and various Courts of Appeal, and we think the conflict between the circuits on this issue should be resolved by a definitive decision of this Honorable Court.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that this petition for writ of certiorari should be granted.

Respectfully submitted,

WILLIAM R. FRAZIER
Counsel of Record
FRAZIER & FRAZIER
Attorneys for Petitioner
1515 Riverside Avenue, Suite A
Jacksonville, Florida 32204
(904) 353-5616

APPENDIX A — JUDGMENT OF THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT DATED JUNE 2, 1993

UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

92-5062

JAMES W. BURKE, as Personal Representative of the ESTATE OF EDNA SPROULL WILLIAMS, deceased,

Plaintiff-Appellant,

v.

THE UNITED STATES,

Defendant-Appellee.

JUDGMENT

ON APPEAL from the UNITED STATES COURT OF FEDERAL CLAIMS

in CASE NO(S). 540-89T

This CAUSE having been heard and considered, it is

ORDERED and ADJUDGED:

AFFIRMED

DATED JUN 02 1993

Appendix A

ENTERED BY ORDER OF THE COURT
s/ Francis X. Gindhart
Francis X. Gindhart, Clerk

ISSUED AS A MANDATE: June 23, 1993

APPENDIX B — OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT DATED JUNE 2, 1993

92-5062

JAMES W. BURKE, as Personal Representative of the ESTATE OF EDNA SPROULL WILLIAMS, Deceased,

Plaintiff-Appellant,

v.

THE UNITED STATES,

Defendant-Appellee.

DECIDED: June 2, 1993

Before NIES, *Chief Judge,* PLAGER and RADER, *Circuit Judges.* NIES, *Chief Judge.*

James W. Burke, as personal representative of the estate of Edna Sproull Williams, appeals from the summary judgment entered by the United States Court of Federal Claims[1] in *Burke v. United States,* No. 540-89T (Cl. Ct. Nov. 27, 1991), that Williams' estate is not entitled to a refund for taxes paid based on the federal estate tax return filed November 24, 1982.

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1. Congress changed the name of the United States Claims Court to the United States Court of Federal Claims, effective October 29, 1992. Pub. L. No. 102-572, § 902(a), 106 Stat. 4506, 4516 (1992).

Appendix B

I.

Edna Sproull Williams died testate on February 28, 1982, while a resident of Jacksonville, Duval County, Florida. James W. Burke is the presently acting personal representative of the Williams estate. Williams' will was filed for probate in the Circuit Court for Duval County, Florida (the probate court) on March 2, 1982.

On November 11, 1982, Burke petitioned the Florida probate court to construe Articles I and XIII of Williams's will under Florida law[2] as authorizing payment of administrative expenses out of the income earned by the estate over the probate period (post-mortem income), rather than requiring payment out of the principal of the estate. Articles I and XIII of Williams' will provide:

> *Article I*
>
> I direct that all my just debts, including expenses of my last illness and funeral expenses be paid by my Personal Representatives as soon as reasonably

2. Florida statute states:

> Unless the will otherwise provides . . . all expenses incurred in connection with the settlement of a decedent's estate, including debts, funeral expenses, estate and other death taxes, family allowances, fees of attorneys and personal representatives, and court costs shall be charged against the principal of the estate.

Fla. Stat. Ann. § 738.05(1) (West Supp. 1992).

convenient after my death. I direct that all estate, inheritance and succession taxes that may be levied against my estate, including such taxes levied against property constituting any part of my estate for federal estate tax purposes, whether passing under this Will or otherwise, shall be paid by my Personal Representatives solely out of the residuary estate being bequeathed hereunder, it being my intention that the portion of my estate devised and bequeathed to or for the benefit of all legatees hereunder, except the residuary legatee, shall be enjoyed by them free from any burden for such estate, inheritance or succesSlon taxes. . . .

Article XIII

I give, devise and bequeath all of the rest, residue and remainder of my estate, including all lapsed legacies or devises, after paying therefrom any debts and taxes, including estate, inheritance, or succession taxes and other obligations of my estate, including all administration expenses, to the Trustees of the Edna Sproull Williams Foundation. . . .[3]

On November 12, 1982, only one day after the unopposed petition for construction was filed, the Florida probate court entered an Order construing the will as follows:

---

3. The Edna Sproull Williams Foundation (hereinafter the "Foundation") qualifies as a charity for purposes of federal estate taxation.

Appendix B

> Articles I and XIII of the decedent's Will are construed to authorize payment of the administrative expenses by the Personal Representatives out of income if they choose to pay such expenses out of income, and to the extent that the Personal Representatives do not choose to pay administrative expenses out of income, such administrative expenses shall be paid out of the residuary share of the estate prior to distribution to the residual beneficiary, as requested in the Petition.

Burke filed the estate's federal estate tax return on November 24, 1982. On the tax return, the entire gross estate was valued at $10,489,753.94. However, the estate claimed deductions totaling $9,747,444.42, leaving a taxable estate of $742,309.52. Included within the total claimed deductions, were charitable deductions totalling $9,662,605.10, of which $8,869,080.10 represented the will's residual bequest to the Foundation. Burke also filed a fiduciary estate income tax return covering income earned by the estate after Williams' death in 1982. On the estate's fiduciary income tax return for 1982, Burke claimed a deduction of $144,441.00 for administrative expenses incurred in administering the estate. With this income tax return, Burke also filed an elective statement under I.R.C. section 642(g) in which the estate waived its right to deduct administrative expenses on the estate's estate tax return.

After auditing the estate tax return, the Commissioner determined that the administrative expenses claimed as a deduction on the estate's income tax return should have been shown on the estate's estate tax return as reducing the charitable deduction which was based upon the residuary clause's bequest to

the Foundation. The Commissioner, thus, reduced the amount of the charitable deduction claimed by the estate by $236,536.38 — the amount of the administrative expenses plus the estate taxes attributable thereto — and assessed an estate tax deficiency of $80,110.87 against Williams' estate. The estate paid the deficiency and brought suit in the Court of Federal Claims, seeking a refund of $110,717 (the $80,110.87 deficiency plus interest).

In response to both parties' cross-motions for summary judgment, the Court of Federal Claims began its analysis by noting that, under the Florida statute, administrative expenses must be paid out of the principal estate unless the will provides otherwise, i.e., unless the will states that such expenses may be paid out of post-mortem income. Further, noting that it was not bound by the Florida probate court's interpretation of the will, the Court of Federal Claims held that "the will did, in fact, provide for the payment of administrative expenses out of the preresidue principal" in Article XIII. *Burke,* No. 540-89T, slip op. at 5-6. The Court of Federal Claims, thus, concluded that the administrative expenses of Williams' estate were required to be paid out of the principal estate.

Before the Court of Federal Claims, Burke argued that the charitable deduction attributable to the residuary bequest to the Foundation should not be decreased because, regardless of the Florida statutory requirement, the administrative expenses had in fact been paid out of post-mortem income and the Foundation had accordingly received a donation at least equal to the amount of the residuary. In response, the court held that "post-mortem income cannot be used to increase the amount of a charitable residual legacy, even by indirectly increasing the amount in the residual bequest." *Id.* at 7. Accordingly, the Court of Federal Claims granted the government's motion for summary judgment. It is from this summary judgment that Burke appeals.

Appendix B

II.

On appeal, Burke does not assert that the Court of Federal Claims erred by granting summary judgment over the existence of a genuine issue of material fact. Rather, Burke argues only that the trial court erred as a matter of law. Burke first argues that the Court of Federal Claims erred as a matter of law by construing Williams' will under Florida law as not allowing payment of the estate's administrative expenses out of post-mortem income, particularly in light of the Florida probate court's decision allowing such payment. Burke also argues that the estate's residuary charitable deduction should not be reduced by the amount of the administrative expenses as a matter of law because the estate in fact[4] paid the administrative expenses out of post-mortem income. The Commissioner argues, not surprisingly, that the Court of Federal Claims correctly interpreted the will and that the use of post-mortem income to pay administrative expenses does not alter the result that the residuary charitable bequest must be reduced by the amount of the administrative expenses for federal estate tax purposes.

While we do not find error in the Court of Federal Claims' determination that under Florida law the will required administrative expenses to be paid out of the principal of the estate,[5] we believe that the emphasis on the source of payment

4. Whether or not Burke actually paid the estate's administrative costs out of post-mortem income is not a genuine issue of material fact in light of our discussion below. For the purpose of our analysis, we must assume that Burke did in fact use post-mortem income to pay the administrative expenses.

5. Addressing the effect of a state court probate determination where the matter decided is determinative of federal estate tax consequences, the Supreme Court has

(Cont'd)

allowable under state law shifts the focus of the case from the pertinent question — whether payment of administrative expenses must be accounted for in computing the value of a taxable estate under federal law for federal estate tax purposes regardless of the actual source of payment.

A.

We have no quarrel with Burke's interpretation of the Florida statute as allowing a decedent to provide for the payment of administrative expenses out of post-mortem income. The Florida statute reflects the reality that often times it may be in the best interest of an estate to pay administrative expenses from post-mortem income instead of from principal. This payment method avoids forcing the personal representative to sell off portions of an estate to cover expenses. For example, emergency sales of personal property such as stocks or real property could unnecessarily deplete the value of the estate.

Nonetheless, while state law may allow for various sources of payment for administrative expenses, such allowance does not necessarily affect the treatment of these expenses for federal estate taxation purposes. As our predecessor court has stated, "Generally speaking, state law is determinative of property rights, while the manner and extent to which such rights are taxed are determined by federal law." *Murray v. United States,* 687 F.2d 386, 392 n.3 (Ct. Cl. 1982) (citing *Morgan v. Commissioner,* 309 U.S. 78, 80-81 (1940)). In other words, the allowable sources of *payment* for

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(Cont'd)
stated, "[W]hen the application of a federal statute is involved, the decision of a state trial court as to an underlying issue of state law should *a fortiori* not be controlling." *Commissioner v. Estate of Bosch,* 387 U.S. 456, 465 (1967).

administrative expenses under *state* law does not necessarily affect the source from which the *deduction* for administrative expenses must be made under *federal* law. *See Lyeth v. Hoey, Collector of the Internal Revenue,* 305 U.S. 188, 193-94 (1938). Therefore, we must examine the federal estate tax statutes in order to determine if payment of administrative expenses from post-mortem income, as potentially allowed by state law, somehow affects a residuary charitable bequest.

B.

Section 2001 of the Internal Revenue Code imposes a tax on the transfer of the "taxable estate" of every decedent who is a citizen or resident of the United States. I.R.C. § 2001.[6] To evaluate a decedent's taxable estate for purposes of section 2001, the administrator must first ascertain the value of the decedent's "gross estate." This value is defined by statute as "the value *at the time of death* of all property, real or personal, tangible or intangible, wherever situated." I.R.C. § 2031(a) (emphasis added).[7] The taxable estate is then calculated by subtracting any amounts qualifying as deductions under sections 2053-2056 from the value of the decedent's gross estate. I.R.C. § 2051. With respect to this case, the deductions at issue are those provided in section 2053 for administrative expenses and in section 2055 for charitable donations.

Section 2051 allows the deduction of various amounts "from

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6. Unless otherwise specified, the statutes and regulations cited hereinbelow are those covering 1982.

7. Section 2032 provides an alternative valuation scheme which does not apply in this case.

the value of the gross estate" in order to determine the taxable estate. One of these deductible amounts is provided for in section 2053 which states that "the value of the taxable estate shall be determined by deducting from the value of the gross estate [administrative expenses] as are allowable by the laws of the jurisdiction . . . under which the estate is being administered." Although section 2053 permits state law to determine what administrative expenses are "allowable," how section 2053 treats the allowable administrative expenses for estate tax deduction purposes is a federal question. *See Lyeth,* 305 U.S. at 193-94.

Section 2051 defines the taxable estate and the deductions used to determine the taxable estate in terms of the gross estate. *See* Treas. Reg. § 20.2051-1 (taxable estate determined by subtracting total amount of deductions "from the total amount which must be included in the gross estate"). Likewise, section 2053, by its plain language, defines the deduction for administrative expenses in terms of the gross estate. Reading sections 2031, 2051, and 2053 together, the gross estate, which is the value of the decedent's estate at the time of death, is the sole source from which the administrative expenses may be deducted.[8] Thus, the deduction of administrative expenses as provided for by federal law — as opposed to the actual payment of administrative expenses as allowed under state law — must come from, i.e., be accounted for within, the gross estate. *See Estate of Street v. Commissioner,* 974 F.2d 723, 728-29 (6th Cir. 1992); *Alston v. United States,* 349 F.2d 87, 88 (5th Cir. 1965); *Estate of Horne v.*

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8. While the tax code apparently allows an estate to elect to *claim* a deduction for administrative expenses on the estate's income tax return instead of on the estate's estate tax return, after filing a waiver under section 642(g), both parties have stipulated that section 642(g) is wholly immaterial to the determination of the charitable deduction to which the present estate is entitled.

Commissioner, 91 T.C. 100 (1988). In other words, regardless of the source of payments for administrative expenses, such payments are charges against the gross estate and must be accounted for accordingly. *See Estate of Street,* 974 F.2d at 728-29 (if estate income is used to pay administrative expenses so as to increase the residue passing to the surviving spouse, the value of the additional residue cannot be included in the amount for the marital deduction); *Alston,* 349 F.2d at 88 ("Administrative expenses must be deducted from the gross estate even though paid out of post-mortem income."); *Rifkind v. United States,* 5 Cl. Ct. 362, 374 (1984) ("Insofar as the New York probate court allows an expense of administration to be paid out of post-mortem income, the accounting practice is at fatal variance with the entrenched principle of federal estate tax law that a decedent's estate must be valued at date of death . . . for purposes of deducting later incurred administration expenses.").

In sum, when a decedent dies, a finite amount known as the gross estate is legally created. Any deductions for expenses incurred in administering the estate are theoretically derived from this amount and, regardless of the actual source of payment, must be accounted for within the gross estate. *See Alston,* 349 F.2d at 88-89; *Rifkind,* 5 Cl. Ct. at 374. *See also Beckwith,* 261-3d *Tax Management Portfolio: Estate and Gift Tax Charitable Deductions* (BNA), at A-23 - A-24; 4 J. Rabkin & M. Johnson, *Federal Income Gift and Estate Taxation,* § 59.07, at 5985 (1992).

Burke argues that the only relevant provision of the tax code is section 2055 which allows a deduction from the decedent's gross estate of amounts given to a qualifying charity. Per Burke, for purposes of the section 2055 deduction, the only requirement is that the charity actually receive the amount claimed as the deduction. Burke argues that since the Foundation received more

than the amount claimed as a deduction under section 2055 over the probate period, the requirements for claiming a deduction are satisfied.

However, the fact that the charitable deduction taken on Burke's federal estate tax return was less than the actual amount received by the charity over the seven-year probate period is not determinative. The relevant inquiry is the amount received by the charity *under the will,* i.e., the amount of the gross estate that passed to the charity. That the charitable donation was augmented by post-mortem income, resulting in an overall charitable donation of an amount greater than the estate tax deduction claimed, does not increase the amount of the charitable bequest under the will.[9]

Under Williams' will, the Foundation received the residue of the estate. Therefore, the value of the gross estate that passed to the Foundation for which the estate may claim a charitable deduction under section 2055, is the amount remaining in the estate after Burke had accounted for all of the obligations of the estate accruing at the time of death. These obligations included payment of the administrative expenses for which the estate claimed a deduction, albeit on the estate's income tax return. In calculating the residue, the amount of the gross estate passing to charity under the will, Burke failed to take into account the reduction

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9. In discussing the amount of residue of an estate qualifying for the marital deduction under section 2056, the Senate Report provides that "[i]f the decedent leaves the residue of his estate to the surviving spouse and she pays, or if estate income is used to pay, claims against the estate so as to increase the residue, such increase in the residue is acquired by purchase and not bequest. Accordingly, the value of any additional part of the residue passing to the surviving spouse cannot be included in the amount for the marital deduction." S. Rep. No. 1013, 80th Cong., 2d Sess. II-6 (1948). While the above provision is framed in the context of the marital deduction, the logic is no less applicable to the present case.

necessitated by administrative expenses. This was error because, for purposes of federal estate taxation, the gross estate is obligated to pay those expenses. In essence, Burke would have us indirectly increase the value of the gross estate by allowing him to use post-mortem income to pay the obligations of the gross estate. While, as we have previously noted, it may be beneficial or convenient to pay such obligations out of post-mortem income, the post-mortem income so used does not itself become part of the gross estate. The result Burke seeks would allow the estate to claim two deductions for the exact same portion of the gross estate as being both an administrative expense deductible under section 2053, which Burke elected to claim on the estate's income tax return, and a charitable donation deductible under section 2055, which Burke claimed on the estate tax return.

The amount of the charitable deduction claimed by Williams' estate was properly reduced by the amount of administrative expenses claimed as a deduction on the estate's fiduciary income tax return because, for federal estate taxation purposes, only this lesser amount was paid to the charity *from the gross estate.* The additional amount paid to charity over the probation period was post-mortem income for which estate received a deduction on its federal income tax returns.

During the pendency of this case, Burke submitted a recent decision, *Estate of Warren v. Commissioner,* No. 91-4401 (5th Cir. Jan. 13, 1993), which he offers in support of his contention that administrative expenses may be paid from post-mortem income without diminishing the amount of the residue passing to charity. Other than the law as determined by the United States Supreme Court, we are bound only by the decisions of the United States Court of Claims and the United States Court of Customs and Patent Appeals, *see South Corp. v. United States,* 690 F.2d 1368, 1370

(Fed. Cir. 1982) (in banc). Thus, we need only consider the Fifth Circuit's decision in *Warren* for its persuasiveness. For the reasons stated in the discussion below, *Warren* does not alter the outcome of this case.

In *Warren,* the decedent's will established two residuary charitable trusts which were to pay annuities to the charities each year equal to eight and one-half percent of the initial fair market value of the trust assets. After twenty years, the trust assets were to be divided among Warren's children and grandchildren. The potential for dispute becomes readily apparent — the higher the payment to the charities throughout the life of the trust, the lower the value of the trust assets which will subsequently be divided among the children and grandchildren. The decedent's estate incurred substantial administrative costs, which, if paid in total from the residuary, would have established relatively small annuity payments for charities and relatively large trust assets at the end of twenty years to be divided among the children and grandchildren.

The charities brought suit in the probate court claiming that the estate's administrative expenses should be paid out of post-mortem income in order to preserve the principal of the trust. The parties settled the case and the probate court entered an agreed final judgment. The parties' agreement provided that 27 1/2 percent of the administrative expenses would be charged to the estate's corpus and 72 1/2 percent of the administrative expenses would be charged to residuary post-mortem income.[10]

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10. These percentages were apparently based on a Texas trust statute which allocates 27 1/2 percent of the income earned by trusts comprising oil and gas assets to the principal of the trust and 72 1/2 percent to income earned by the trust. Texas Trust Code, Tex. Prop. Code Ann. § 113.107(d) (West 1984).

Appendix B

After auditing the estate's estate tax return, the Commissioner asserted an estate tax deficiency. Before the Tax Court, the Commissioner argued that the estate had improperly failed to decrease its charitable donation deduction by the full value of the administrative expenses. The estate argued that, according to the agreed settlement judgment entered by the probate court, the charitable donation claimed on the estate tax return had to be reduced only by 27 1/2 percent of the administrative expenses. The Tax Court determined that it was not bound by the probate court's judgment and agreed with the Commissioner.

On appeal, the Fifth Circuit concluded that the *Bosch* rule, that a state trial court probate decision does not control the application of the federal estate tax statute,[11] was limited to situations in which the state court's decision was the result of non-adversarial proceedings. Therefore, per the Fifth Circuit, the Tax Court was bound by the state probate court's decision because it resulted from a bona fide adversarial proceeding between the various beneficiaries under the will. The Fifth Circuit also found it significant that the government failed to submit evidence supporting its allegation that the settlement between the parties was structured to avoid federal tax liability.

In the case at bar, there was no *bona fide* adversarial proceeding leading to the Florida probate court's decision to allow payment of administrative expenses out of post-mortem income. Therefore, even assuming that *Bosch* is limited to non-adversarial situations, it is applicable to this case. Moreover, neither of the parties in this case contends that the Court of Federal Claims or the Federal Circuit should be bound, as opposed to merely influenced by the Florida probate court's decision.

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11. *See supra* note 5.

Appendix B

Even if the decision in *Warren* were applicable to the present case we would decline to follow it. By allowing state court decisions to bind federal courts on issues which are clearly federal tax law issues, *Warren* would subject the federal tax system to "the whim of the state courts or legislatures." *Estate of Street,* 974 F.2d at 728. Further, the decision in *Warren* would allow an agreement between the beneficiaries under a will to dictate federal estate tax law. While the settlement in *Warren* was undoubtedly the result of adversarial proceedings, it is hard to imagine that reducing federal estate tax consequences was not at least one aspect of the settlement agreement. Decreasing the amount of taxes owed would increase the overall post-tax amount of money which could be divided by both of the negotiating parties. Moreover, the Fifth Circuit's holding in *Warren* appears contra to its earlier decision in *Alston v. United States, supra,* in which the court held that "administrative expenses must be deducted from the gross estate even though paid out of post-mortem income." *Alston,* 349 F.2d at 88.

CONCLUSION

The Court of Federal Claims correctly held that, as a matter of federal law, Burke could not indirectly increase the amount of the charitable residual legacy by paying administrative expenses out of post-mortem income. Accordingly, we affirm the trial court's decision that the Commissioner correctly reduced the estate's claimed charitable deduction to account for the amount of the administrative expenses deducted from the estate's income taxes and that Williams' estate is not entitled to a refund.

AFFIRMED

APPENDIX C — OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT DATED JUNE 2, 1993

OPINION ANNOUNCING
JUDGMENT OF THE COURT

OPINION FILED AND JUDGMENT ENTERED: JUN 02 1993

The attached opinion announcing the judgment of the court in your case was filed today. The judgment was also entered pursuant to Rule 36. The mandate will be issued in due course.

Costs may be recoverable under Rule 39 or as the court may have directed in the opinion. A party entitled to costs is provided with a bill-of-costs form and an instruction sheet with this notice.

The parties are encouraged to stipulate to the costs. A bill of costs will be presumed correct in the absence of a timely filed objection.

Costs when taxed are payable to the party awarded its costs. If costs are awarded to the government, they should be paid to the Treasurer of the United States. Payment should be made to counsel for the party awarded costs or, if the party is not represented by counsel, to the party pro se. Costs should be paid promptly.

If the court also imposed monetary sanctions, they are payable to the opposing party unless the court's opinion provides otherwise. Sanctions should be paid in the same way as costs.

Exhibits and visual aids shall be promptly retrieved by the party that lodged them with this court.

Appendix C

FRANCIS X. GINDHART
Clerk

BURKE V US, 92-5062
(CLM - 540-89T)

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APPENDIX D — DECISION OF THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT IN THE CASE OF ESTATE OF DOROTHY J. WARREN, DECEASED, ET AL. V. COMMISSIONER OF INTERNAL REVENUE DATED JANUARY 13, 1993

[¶ 60,127] Estate of Dorothy J. Warren, Deceased, River Oaks Trust Company and R. Clay Underwood, Co-Administrators with Will Annexed of the Estate of Dorothy J. Warren, Deceased, Petitioners-Appellants v. Commissioner of Internal Revenue, Respondent-Appellee.

U.S. Court of Appeals for the Fifth Circuit, No. 91-4401, January 13, 1993. Reversing and remanding the decision of the United States Tax Court, 60 TCM 206, CCH Dec. 46,742(M).

[Code Sec. 2055]

Estate tax: Deductions: Charitable transfers: Allocation of administration expenses. — An estate was entitled to allocate 27 1/2 percent of its administrative expenses against residuary assets passing to charitable lead trusts and 72 1/2 percent of the expenses to the estate's postmortem income pursuant to a state (Texas) probate court decree. Although the decedent's will provided that all administration expenses were to be paid from the residuary estate, the state court decree modified and approved a settlement that resolved adversarial, nontax, bona fide disputes between the parties. Concluding that the state court decree was valid and binding under Texas law, the court followed the approach in Rev. Rul. 89-31, 1989-1 CB 277, rather then *H. J. Bosch Est.*, 67-2 USTC ¶ 12,472, 387 US 456, holding that the estate tax charitable deduction must be computed on the basis of what the charities received under the will pursuant to the state court decree. Back reference: ¶ 7425.18.

Appendix D

Before *Reynaldo G. Garza, Garwood,* and *Duhé*, Circuit Judges.

Garwood, Circuit Judge: Petitioners-appellants, the estate of Dorothy J. Warren and its administrators (together, the Estate) appeal the judgment of the United States Tax Court essentially upholding the Internal Revenue Service's estate tax deficiency determination against the Estate. We reverse.

I

Facts and Proceedings Below

The deceased, Dorothy J. Warren (Warren), a Texas resident, was a wealthy divorcee with several children and grandchildren, and an affinity for two Catholic charities in Houston (the Charities). When she died on May 27, 1983, she left a will, executed in 1981, disposing of her estate, which at the time of her death had a gross value of approximately $28 million. Most of the estate's assets consisted of oil and gas leases, or interests therein, in Texas and Louisiana. Article V of the will put the bulk of the estate into two equal residuary trusts, the Charitable Lead Children's Trust and the Charitable Lead Grandchildren's Trust (the Trusts). The Trusts provided for a fixed annual annuity payment to the Charities for twenty years. The annuity amount was specified as "an amount equal to eight and one-half percent (8 1/2%) of the initial net fair market value of the assets constituting the trust." The annuity amount was to be paid every year from trust income. If excess income were generated in a year, such excess was to be added to the trust corpus. If the income was not sufficient to pay the annuity amount, however, the balance would be paid out of the trust corpus.

At the end of twenty years, the remaining trust assets were to be distributed to the children and grandchildren. This arrangement

was instituted primarily to further Warren's testamentary goals in a way that minimized that tax burden on the estate. The large guaranteed annuities to the Charities assured that much of the estate would qualify for the charitable bequest deduction of Internal Revenue Code (Code) § 2055(a) & (e)(2)(B), 26 U.S.C. § 2055(a) & (e)(2)(B) (West 1989).

Warren's will was admitted to probate in September 1983 in Probate Court No. 3 of Dallas County, Texas (the Probate Court). Between 1983 and 1987 approximately sixteen separate law suits were filed by or against the estate in the Probate Court, including suits by creditors and suits challenging the construction and administration of the will and estate. These suits involved, among others, all the beneficiaries and legatees of the will and dragged on for several years.

Because of the reorganization of several of the business enterprises that comprised a substantial part of Warren's assets, the administrative expenses incurred throughout the long course of probate proceedings swelled to over $8.5 million by July 1988 and over $9 million by November 1989. Approximately $2 million of these expenses were paid from Estate principal. Due to the extended time involved, the Estate also realized substantial postmortem income from the Estate's assets.[1] Article III of Warren's will provided that:

> "All of my just debts, funeral expense, administration and testamentary expenses, and all estate, inheritance, transfer, and succession

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1. By "postmortem income" we mean income derived from estate assets between the time of Warren's death and the time the probate of her estate was substantially completed.

> taxes . . . shall be paid out of my residuary estate passing under Article V hereof, without apportionment."

Article V of the will states that " 'my residuary estate' " is to "consist of my entire testamentary estate after satisfaction of any gifts under Article IV hereof, and after payment of those debts, expenses, and taxes referred to in Article III hereof."

Because the huge administrative expenses, if deducted from the residuary corpus, would have substantially reduced the annuity amount, the Charities brought suit in the Probate Court claiming, *inter alia,* that these expenses should be paid out of residuary postmortem income rather than the residuary corpus.[2] The parties found ambiguity in the will's use of the terms "residuary estate" and "initial net fair market value" and argued extensively about whether the administrative expenses should be charged to the residuary corpus or postmortem income.

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2. This postmortem income consisted largely of income from oil and gas holdings of a kind that the provisions of the Texas Trust Code, Tex. Prop. Code Ann. § 113.107(d) (West 1984) (formerly Vernon's Ann. Tex. Civ. Stat. art. 7425b-33), direct that trusts apportion 27 1/2 % (but not to exceed 50% of the net after deducting the property's expense and carrying cost) to trust corpus and the balance to income. The Texas Trust Code also provides that "[i]f an asset becomes subject to a trust under a will, it becomes subject to the trust as of the date of the death of the testator, even though there is an intervening period of administration of the testator's estate," Tex. Prop. Code § 113.103(a) (formerly Vernon's Ann. Civ. Stat. art. 7425b-28) and that "[i]f the provisions of . . . [the Texas Trust code] and the terms of a trust conflict, the terms of the trust control." *Id.* § 111.002(a). Article II of the Will granted the estate's personal representative, among other things, "all of the rights and powers conferred upon a trustee by the Texas Trust Act and other laws of Texas." Texas Property Code Ann. § 113.019 (West 1984) (formerly Vernon's Ann. Tex. Civ. Stat. art. 7425b-25) grants trustees the power to compromise and settle claims.

Appendix D

The parties to most of the suits, including the administrators, the Charities, the children and grandchildren, and most claimants against the Estate, were finally able to reach a settlement of their claims in July 1987. Included in this omnibus settlement was a provision that Article III of the will would be restated to allocate payment of all administrative expenses out of the residuary postmortem income, not out of the residuary corpus.

The Probate Court modified and approved the settlement and entered an agreed final judgment in September 1988. The Probate Court found that because (i) the income from the oil and gas interests would be allocated 27 1/2% to principal and 72 1/2% to income,[3] and (ii) the postmortem income was the only liquid asset available to the residuary estate to pay the administrative expenses, the administrative expenses should be allocated accordingly. Thus, the agreed final judgment provided that 27 1/2% of the administrative expenses would be charged to the residuary corpus and 72 1/2 % of the administrative expenses would be charged to residuary postmortem income.[4] It was also provided that the annuity amount would in no event be less than $1,471,575.81 per year.

Respondent-appellee, the Commissioner of Internal Revenue (the Commissioner), having asserted an estate tax deficiency, the

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3. See note 2, *supra*.

4. The judgment provided that the will's Article V "the initial net fair market value of the assets constituting" each of the two Trusts would be one-half of the amount calculated as follows, *viz*, the total gross estate as calculated for federal estate tax purposes less the specific bequests in Article IV, less 27 1/2% of the administrative expenses paid to date, and less all of each of the following: funeral expenses, debts of decedent, mortgages and liens, and federal estate taxes and state death taxes.

Estate filed a petition for redetermination in the Tax Court. Most of the issues were settled.[5] However, there remained for trial the issue of whether in calculating the amount of the estate tax charitable deduction for the bequest to the Trusts under Article V of the will the amount of "the initial net fair market value of the assets constituting the" Trusts should be reduced by one hundred percent of the Estate's administrative expenses, as claimed by the Commissioner, or only by the 27 1/2% thereof pursuant to the Probate Court's judgment, as asserted by the Estate. The Tax Court agreed with the Commissioner, determining that it was not bound by the Probate Court's judgment and that under Texas law Warren's will required that all the administrative expenses be charged to the residuary corpus before computing "the initial net fair market value of the assets constituting the trust," eight-and-one-half percent of which was to constitute the annual annuity amount payable to the Charities over the twenty-year term. Following the

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5. The initial estate tax return filed by the Estate in 1984 left many of the crucial items blank or "undetermined." The Commissioner issued a notice of deficiency in the amount of $34,340,734.68, which the government's brief states was "based largely on the values for the assets and debts of the estate contained in the marriage Settlement Agreement between the decedent and her fomer husband that had been executed the year before her death," although the Estate asserts that "the bulk" of the deficiency "resulted from" the Commissioner's position that the Charities "were not qualified charitable organizations." In any event, it was eventually agreed: that the value of the total gross estate for estate tax purposes was $28,352,319.92; that as of July 31, 1988, the Estate had incurred and paid $8,523,834.44 ($9,085,849.61 as of November 28, 1984) in administrative expenses and that such expenses were allowable as a deduction for estate tax purposes under Code § 2053(a)(2) to the extent the Estate elected to so deduct them (and not to deduct them for income tax purposes, see Code § 642(g)); that the Charities were qualified charities for the purposes of the estate tax charitable deduction (Code § 2055(a)); and that the Article V bequest to the Charities was in the form of a guaranteed annuity for purposes of Code § 2055(e)(2)(B).

Tax Court's opinion, final judgment was entered on the basis of an agreed "Computation For Entry of Decision." The effect of the Tax Court's decision was to reduce the amount of the annual annuity payable to the Charities, for purposes of the estate tax charitable deduction, from some $1,471,575, under the Probate Court's judgment, to $878,131, with a consequent reduction in the estate tax charitable deduction from some $16,878,827 to $10,072,070.[6] The Estate timely perfected this appeal.

DISCUSSION

In determining that it was not bound by the decision of the Texas Probate Court in allocating administrative expenses, the Tax Court relied on *C.I.R. v. Estate of Bosch* [67-2 USTC ¶ 12,472], 87 S.Ct. 1776, (1967).

In *Bosch,* and its companion case of *Second National Bank of New Haven v. United States,* the Supreme Court reviewed decisions of the Second Circuit from New York and Connecticut, respectively *C.I.R. v. Estate of Bosch* [67-2 USTC ¶ 12,491], 363 F.2d 1009 (1966), and *Second National Bank of New Haven v. United States,* 351 F.2d 489 (1965), in which the estate tax marital deduction was at issue. The New York case involved a revocable trust established by the decedent in which his surviving spouse had

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6. The Computation For Entry of Decision calculated the estate tax charitable deduction amount as 11.4699 times the amount of the 8 1/2% annual annuity, or 97.49415%(8 1/2% x 11.4699) of the corpus of the Trusts ($10,330,948.61 after deducting from the residuary estate, *inter alia,* all the $9,085,849.61 in administrative expenses). See 26 C.F.R. §§ 20.2031-10 (Table B), 20.2055-2(e)(2)(vi), 20.2055-2(f)(2)(iv). The allowed estate tax deductions also included $3,855.05 funeral expenses, $1,656,925.75 debts, $4,809,843 mortgages and liens, and $9,085,849.61 administrative expenses (exclusive of interest). The Estate received the right, in the event the Tax Court's decision were reversed, to deduct less than all of such administrative expenses for estate tax purposes, presumably so that in that event it could instead deduct such expenses for income tax purposes. See Code § 642(g).

had a life estate with a general power of appointment as to which she subsequently, but before his death, executed an instrument purporting to release the general power and convert it into a special power. The Commissioner disallowed the marital deduction because the surviving spouse did not have a general power of appointment, due to the release instrument. While the case was pending in the Tax Court, the estate filed a proceeding in a New York trial court to declare the release of a nullity, and the New York trial court so declared it. As the Second Circuit's opinion reflects, it was conceded that the state proceeding was brought at least partially for the purpose of affecting the outcome of the Tax Court case, all concerned in the state case took the position there that the release was a nullity, and no contrary argument was presented to the state court. *Bosch,* 363 F.2d at 1011. The Tax Court and the Second Circuit, over Judge Friendly's dissent, held for the estate on the basis of the state trial court judgment, even though it was recognized that the state proceedings were essentially "non-adversary." *Id.* at 1013. The Connecticut case involved a dispute as to the amount of the marital deduction, which turned on whether the state statute apportioning estate and inheritance taxes in the absence of a contrary provision in the will applied, with a greater marital deduction resulting if the statute applied. After the Commissioner asserted a deficiency based on the inapplicability of the apportionment statute, the executor filed an application in the Connecticut Probate Court to have the estate taxes prorated under the statute, and all charged against the trust for the grandchildren rather than the marital deduction trust. Others interested in the estate, including the other beneficiaries under the will, though cited, did not contest the application, and some filed statements of no objection. The Probate Court granted the application. *Bosch,* 87 S.Ct. at 1780. The Second Circuit ultimately affirmed a summary judgment in favor of the Internal Revenue Service (IRS) on this issue, holding that the will unambiguously reflected that the state

proration statute would not apply, and that the Probate Court's contrary decision did not require a different result, noting that the judges of such courts are laymen and their decisions "are even subject to collateral attack in another probate district." *Second National Bank of New Haven*, 351 F.2d at 494.

The Supreme Court affirmed in the Connecticut case and remanded to the Second Circuit in the New York case, holding that the respective state trial court decisions were not to be given "controlling" effect. *Bosch*, 87 S.Ct. at 1782.

The Supreme Court initially noted that "at least three positions have emerged among the circuits" respecting the effect of state trial court decrees "where the matter decided there is determinative of federal estate tax consequences." *Id.* at 1781. It next described these positions without evaluating them. The first it characterized as treating the state court ruling as decisive if the issue was "fairly presented for its independent decision" and was "binding upon the parties under the state law." *Id.* The second position, characterized as "[t]he opposite view" and one which "seems to approach" the methodology employed in diversity cases to determine state law, was that the federal courts would be bound by the state court ruling "only after independent examination of the state law as determined by the highest court of the State." *Id.* The third view, advocated by the government as "an intermediate position," was that "a state trial court adjudication is binding in such cases only when the judgment is the result of an adversary proceeding in the state court." *Id.* at 1782.

The next paragraph of the Court's opinion commences by stating "[w]e look at the problem differently." *Id.* The Court explains "[f]irst" that neither *res judicata* nor *collateral estoppel* apply to the cases before it because the Commissioner was not a

party to either of the state court proceedings. It then observes that "both state proceedings were brought for the purpose of directly affecting federal estate tax liability." *Id.* "Next" the opinion points out that because the issue before it involves "a federal taxing statute," the Court "must look to the legislative history surrounding it," and then observes:

> "the report of the Senate Finance Committee recommending enactment of the marital deduction used very guarded language in referring to the very question involved here. It said that 'proper regard,' not finality, 'should be given to interpretations of the will' by state courts and then only when entered by a court 'in a bona fide adversary proceeding.' S.Rep. No. 1013, Pt. 2, 80th Cong., 2d Sess., 4. We cannot say that the authors of this directive intended that the decrees of state trial courts were to be conclusive and binding on the computation of the federal estate tax as levied by the Congress. If the Congress had intended state trial court determinations to have that effect on the federal actions, it certainly would have said so — which it did not do. On the contrary, we believe it intended the marital deduction to be strictly construed and applied. Not only did it indicate that only 'proper regard' was to be accorded state decrees but it placed specific limitations on the allowance of the deduction as set out in § 2056(b), (c), and (d)." *Id.*

The Court goes on to say that "[t]his is also in keeping

with . . . the Rules of Decision Act, 28 U.S.C. § 1652" and the Court's precedents holding that "even in diversity cases" decisions of " 'lower state courts' " though " 'attributed some weight' " are not " 'controlling' " if "the highest court of the State has not spoken on the point." *Id.* It then notes that:

> "[t]his is not a diversity case but the same principle may be applied for the same reasons, *viz.*, the underlying substantive rule involved is based on state law and the State's highest court is the best authority on its own law. If there be no decision by that court then federal authorities must apply what they find to be the state law after giving 'proper regard' to relevant rulings of other courts of the State." *Id.* at 1783.

The concluding substantive paragraph of *Bosch* states "[w]e believe that this would avoid much of the uncertainty that would result from the 'non-adversary' approach and at the same time would be fair to the taxpayer and protect the federal revenue as well." *Id.*

The precise scope and meaning of *Bosch* as applied in dissimilar contexts is difficult for us to ascertain. The Court's language "[w]e look at the problem differently" suggests that it was not entirely agreeing with any of the three general positions described, but not evaluated, in the immediately preceding paragraph of the opinion. Later language in the opinion, however, indicates that it was adopting the second position (although it never expressly so states). Was the Court, perhaps, leaving open the proper approach in other contexts, such as federal tax consequences not relating to the marital deduction, which is so

heavily emphasized as a ground for decision? We note in this connection that *Bosch* distinguished *Blair v. Commissioner,* 57 S.Ct. 330, (1937), an income tax case, on the ground that it "involved the question of a property right determination by a state appellate court." *Bosch,* at 1781 n.3. *Bosch* also involved state trial court decrees in cases brought by the taxpayer "for the purpose of directly affecting federal estate tax liability." Moreover, the opinion makes clear that adversarial positions were not taken by the parties in the state cases, not withstanding its seeming rejection of "the 'non-adversary' approach." Some authorities have concluded that *Bosch* does not vitiate the significance of *bona fide* adversarial settlements. *See Waldrup v. United States,* 499 F.Supp. 820, 824 n.4 (N.D. Miss. 1990); *but see Estate of Brandon v. C.I.R.* [87-2 USTC ¶ 13,733], 828 F.2d 493,499 (8th Cir. 1987) (marital deduction case; *Bosch* applies to good faith adversary settlements).

In the estate tax charitable deduction area, though without citing *Bosch,* controlling effect has frequently been given to *bona fide* settlements of adversarial litigation not instituted for tax purposes. *See Flanagan v. United States* [87-1 USTC ¶ 13,718], 810 F.2d 930 (10th Cir. 1987); *Estate of Strock v. United States,* 655 F.Supp. 1334 (W.D. Pa. 1987); *Northern Trust Co. v. United States,* 41 A.F.T.R.2d 78-1523 (N.D.Ill. 1977);[7] Rev. Rul. 89-31, 1989-1, C.B. 277 (revoking prior contrary ruling and holding "[i]n situations involving settlements of bona fide will contests the Service will no longer challenge the deductibility of immediate payments to charities solely on the ground that they were made in

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7. *Northern Trust Co.* has frequently been cited with approval. *See, e.g., Oetting v. United States* [83-2 USTC ¶ 13,533], 712 F.2d 358, 361 (8th Cir. 1983); *First National Bank of Fayetteville v. United States* [84-1 USTC ¶ 13,558], 727 F.2d 741, 748 (8th Cir. 1984); Rev. Rul. 89-31, 1989-1, C.B. 277.

lieu of a split interest [provided for in the will] that would not constitute an allowable deduction under section 2055(e)(2) of the [Internal Revenue] Code"); Technical Advice Memorandum 8948004 (August 25, 1989).[8]

In *Brown v. United States,* 890 F.2d 1329, 1341-43 (5th Cir. 1989), we considered *Bosch* and ultimately concluded that "[t]he relevance of a state court's judgment to the resolution of a federal tax question will vary, depending on the particular tax statute involved as well as the nature of the state proceeding that produced the judgment." *Id.* at 1342.[9] We apply that test here and conclude

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8. This directive applied Rev. Rul. 89-31 to a situation where the *bona fide* settlement not only gave the charity an immediate payment in lieu of the nonqualifying split interest provided for it in the will, but also provided that the charity would be exonerated from paying any portion of the estate taxes notwithstanding that the "will specifically provides that estate taxes are to be paid out of the charitable residue as an expense of administration without apportionment." In reaching this result it is stated "[a] bona fide settlement agreement results in a restructuring of the terms of the will so that the beneficiaries' interests are based on the restructured will. See Rev. Rul. 89-31, *supra.* Thus the provisions of a bona fide settlement agreement prevail over the provisions of the will."

9. In *Brown* we held the Texas Probate Court order finding that the estate, administered by an independent executor, required ongoing management and administration, did not preclude the Commissioner from determining under Treasury Regulation 1.641(b)-(3)(a) that administration of the estate had already been unduly prolonged. We noted that the executor did not file the probate proceeding until after the deficiency notice, *id.* at 1341, "the nonadversary quality" of that proceeding, and the fact that the Probate Court "was not presented with all the relevant facts and differing views." *Id.* at 1342. We further observed "[n]ot only was there no genuine controversy involved, the probate court's order was unneccessary" and "had no practical consequences apart from this federal tax controversy." *Id.* We held it was thus "entitled to little weight." *Id.*

that the Tax Court erred by not giving effect to the Probate Court judgment.

The tax statute involved here is the provision for estate tax charitable deduction, Code § 2055. In this respect, we are aware of no legislative history comparable to that cited in *Bosch* with respect to the effect of state court decrees.[10] However, as has been frequently recognized, "[i]n enacting the charitable deduction provisions in I.R.C. § 2055 and its predecessors, Congress sought to encourage gifts to charity." *Flanagan* at 934. Typically, in upholding charitable deductions based on court approved *bona fide* settlements of adversarial positions, the decisions have stressed that "[t]he deduction is sought for the actual benefit passing to the charitable foundation." *Id.* at 935. *See also Oetting v. United States* [83-2 USTC ¶ 13,533], 712 F.2d 358 at 363 (8th Cir. 1983) ("A deduction is claimed only for those amounts that were actually received by the four charities. The deduction should be allowed.").[11] That is the situation here, as the Estate seeks a deduction only on the basis of what the Charities will actually receive from the Estate. Of course, for purposes of section 2055 what is received must be received *from the decedent,* and not merely from those who take the decedent's estate. But where the settlement is a *bona fide* resolution of a truly adversarial dispute as

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10. Nor are we aware of any federal estate tax requirement or preference for charging administrative expenses to residuary corpus.

11. *Cf. Estate of Wright v. United States,* 677 F.2d 53 (9th Cir. 1982) ("The paramount concern, for federal tax purposes, is with the real distribution of the funds rather than their nominal source," at 54, and, " 'the amount to be deducted for charitable gifts must be computed on the basis of what the charities actually received, not on the basis of what is provided in the will,' " at 55).

to rights of the charity under a will of the decedent, then the foregoing requirement would appear to be satisfied, for in such a case what the charity receives it receives *as a result and by virtue of* the provision made for it in the decedent's will, whether or not it receives precisely what it would be entitled to if no settlement had been made. The contrary conclusion would be necessarily inconsistent with Rev. Rul. 89-31 as well as with such decisions as *Flanagan, Northern Trust Co.,* and *Estate of Strock. See also Dumont's Estate v. C.I.R.* [45-2 USTC ¶ 10,216], 150 F.2d 691, 692-94 (3d Cir. 1945).

We further note that the settlement and Probate Court judgment are wholly valid and binding under Texas law, and under Texas law control the extent to which the administrative expenses are charged to the residuary estate for purposes of computing "the initial net fair market value of the assets constituting" the Trusts. *See Mooney v. Harlin,* 622 S.W.2d 83, 85 (Tex. 1981) (binding nature of Texas Probate Court judgments, which are *in rem*). Texas law has long recognized the "family settlement doctrine." As stated in *Matter of Estate of Hodges,* 725 S.W.2d 265, 267 (Tex. App. — Amarillo, 1986, writ ref'd n.r.e.):

> "A family settlement agreement is an alternative method of administration in Texas that is a favorite of the law. *Salmon v. Salmon,* 395 S.W.2d 29, 32 (Tex. 1965); *Estate of Morris,* 577 S.W.2d 748, 755-56 (Tex. Civ. App. — Amarillo 1979, writ ref'd n.r.e.). The Theory underlying the validity of family settlement is stated in *Pitner v. United States* [68-1 USTC ¶ 12,499], 388 F.2d 651, 656 (5th Cir. 1967):

Appendix D

> 'This approach is made possible by section 37 of the [Texas] Probate Code which provides that when a person dies leaving a will, [. . .] "all of his estate devised or bequeathed by such will shall vest immediately in the devisees or legatees;" [. . .] subject to the payment of the decedent's debts. This provision leaves the beneficiaries of an estate free to arrange among themselves for the distribution of the estate and for the payment of expenses from that estate.' " (Footnote omitted).

See also Cook v. Hamer, 309 S.W.2d 54, 56 (Tex. 1958); *Wade v. Wade,* 167 S.W.2d 1008, 1010 (Tex. 1943); *Everett v. Everett,* 309 S.W.2d 893, 896 (Tex.Civ.App. — Waco 1958, writ ref'd n.r.e.). In *Pitner* we applied the Texas family settlement doctrine in holding that certain postmortem attorneys' fees were deductible for estate tax purposes as administrative expenses under Code § 2053(a)(2). *Pitner v. United States,* 388 F.2d 651 (5th Cir. 1967).

Though the Tax Court in this case specifically refused to make a finding as to whether the agreed allocation of administrative expenses was a settlement of a bona fide dispute, the Commissioner argues precisely this point on appeal. He claims, as he did below, that the settlement, at least as far as it dealt with the allocation of administrative expenses, was collusive and designed simply to avoid payment of taxes, and that the IRS should not now be forced to abide by a settlement in which it had no voice.

We reject the Commissioner's argument. This contention was thoroughly tried below, and, as the Estate points out, the Commissioner never produced any evidence with which to question the character of the proceedings. The Estate, on the other

hand, presented the testimony of Alan Leibel, an attorney who represented Warren's children throughout the litigation in the Probate Court. Leibel testified that the negotiations, on the administrative expense issue as well as others, were protracted and adversarial.

It is indisputably clear that the litigation, and its settlement, were to resolve adversarial, nontax, *bona fide* disputes between the parties.

We also note that the terms of the will provide independent verification of the adversarial interests involved in the probate contest. If all administrative expenses had been taken out of the corpus of the residuary estate so that "the initial net fair market value" of the assets of the Trusts would have been lower, the annuity amount received by the Charities would likewise have been lower. This would have benefited the children and grandchildren because less of the estate would have been paid out to the Charities and more would have been left to them after the twenty-year term of the Trusts.

As calculated by the Commissioner and under the Tax Court's judgment, the annuity payments to the Charities were $878,131 a year, as compared to $1,471,576 per year under the Probate Court's judgment, a difference of $593,445 a year. Over the 20-year term this would amount to $11,868,904 more going to the Charities, and the same amount less being available to Warren's children and grandchildren at the termination of the Trusts (the children and grandchildren receiving nothing from the Trusts prior to their termination).

The Commissioner's brief makes the conclusory assertion that because "[t]he net effect of this allocation of administrative

expenses was to reduce both the federal estate and income tax burdens of the estate" the settlement "was not adverse to the interests of the various parties to" it and hence was not *bona fide* and adversarial. The record simply does not bear this out. The Commissioner's position and that of the Tax court reduced the amount of the estate tax charitable deduction by approximately $6,806,756 from what it would have been had the Probate Court judgment been followed.[12] Even as calculated by the Commissioner, the net taxable estate was only $2,357,320, and so the maximum estate tax rate would have been 49%. Code § 2001(c)(1). Of course, if the Probate Court position were applied, the same estate tax liability as resulted from the Tax Court's judgment could be achieved without using as an estate tax deduction some $6,806,756 (the amount of the decrease in the estate tax charitable deduction) of administrative expenses, which in turn would free that amount up to take as an estate income tax deduction.[13] The maximum income tax rate for estates and trusts during 1983 through 1986 was fifty percent and has been less ever since. Code § 1(e). Consequently, the tax benefits — estate tax and income tax — in regard to the administrative expenses and the estate tax charitable deduction could not have amounted in all to more than half the amount of the difference in the size of the estate tax charitable deduction, or some $3,403,378 (1/2 of $6,806,756). In addition to this tax benefit, there would be, if the Probate Court judgment were followed, the potential for increased annual income tax deductions by the virtue of the increase in the amount of the annual annuity payable to the Charities by $593,445. Even on the

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12. The $593,445 difference in the annual annuity amount times the appropriate 11.4699 factor (see note 6, *supra*) equals $6,806,756.

13. Under Code § 642(g) an item of administrative expense may not be taken both as an estate tax and as an income tax deduction.

unlikely assumption that there would be sufficient net taxable income to realize the full potential of this increased deduction (in addition to the hypothesized income tax deduction for administrative expenses), over the 20-year term it would not amount to a tax saving of over some $4,255,000.[14] The total of the maximum potential estate and income tax savings from administrative expenses, $3,403,378, plus the maximum potential income tax savings from the increased charitable deduction for increased annuity payments to charity, $4,255,000, would thus be less than $7,660,000. This would still leave more than $4,000,000 ($11,868,904, the pre-tax loss to the children and grandchildren, less $7,660,000 in maximum potential tax savings, the benefit of which could accrue to them on termination of the Trusts) to fight over. That is a substantial sum, and a substantial fraction of the net estate. The Commissioner has presented no calculations whatever to demonstrate what the potential tax savings would be or that they would even approach the amount of the enhancement in the position of the Charities to the detriment of the children and grandchildren.

The record as a whole affirmatively demonstrates that the dispute was a truly adversariel, nontax one and that the parties reached an arms-length and *bona fide* settlement of that dispute

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14. The top income tax for estates in the years 1983 through 1986 was 50%; in 1987 through 1990 it did not exceed 38.5%; since then it has not exceeded 31%. See Code §1. Assuming 3.6 years (May 27, 1983 through December 1986) at 50%, 4 years at 38.5%, and 12.4 years at 31%, the total income tax savings over the 20 years from the increased income tax charitable deduction would be approximately $4,253,328, calculated as follows:

3.6	x	$593,445	=	$2,136,440.20	x	.50	=	$1,068,220.10
4	x	$593,445	=	$2,373,780	x	.385	=	$ 913,905.30

that was essentially approved by the Probate Court, and that what the Charities received in the settlement and under the Probate Court judgment accrued to them by virtue and as a result of the bequest to them in Article V of the will. There is no substantial evidence in the record to sustain a contrary finding. Consequently, there is no need for a remand to the Tax Court for a fact finding on that issue. We further determine that the settlement and Probate Court decree are valid and binding under Texas law, particularly the Texas family settlement doctrine. In these circumstances, we conclude that the approach of Rev. Rul. 89-31, rather than of *Bosch,* is appropriate, and that the estate tax charitable deduction should be computed on the basis of what the Charities will receive under Article V of the will pursuant to the Probate Court's judgment.

Conclusion

We hold that the estate tax charitable deduction must be computed on the basis of what the Charities will receive under Article V of the will pursuant to the Probate Court's judgment, and that the Tax Court erred in holding to the contrary. We accordingly reverse the judgment of the Tax Court and remand the case to that court for further proceedings consistent herewith, including recalculation of the appropriate estate tax in conformity with our holding.

APPENDIX E — JUDGMENT OF THE UNITED STATES CLAIMS COURT FILED NOVEMBER 29, 1991

IN THE UNITED STATES CLAIMS COURT

No. 540-89 T

JAMES W. BURKE, AS PERSONAL REPRESENTATIVE OF THE ESTATE OF EDNA SPROULL WILLIAMS, DECEASED

v.

THE UNITED STATES

JUDGMENT

Pursuant to the order of November 27, 1991.

IT IS ORDERED AND ADJUDGED this date, pursuant to Rule 58, that the complaint is dismissed. No costs.

David A. Lampen
Clerk of Court
By: s/ Linda A. Eddin
Deputy Clerk

NOTE: As to appeal, 60 days from this date, see RUSCC 72, re number of copies and listing of *all plaintiffs*. Filing fee is $105.00.

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APPENDIX F — ORDER OF THE UNITED STATES CLAIMS COURT FILED NOVEMBER 27, 1991

IN THE UNITED STATES CLAIMS COURT

No. 540-89T

(Filed: November 27, 1991)

JAMES W. BURKE, as Personal Representative of the Estate of EDNA SPROULL WILLIAMS, Deceased

v.

THE UNITED STATES

ORDER

This suit was brought by the personal representative of the estate of Edna Sproull Williams to obtain a refund of $110,717 paid to the defendant United States of America (Government) because of an asserted tax deficiency. The matter is before the court on the Government's motion for summary judgment and on plaintiff's crossmotion for summary judgment under RUSCC 56.

Facts

The following facts are undisputed. Edna Sproull Williams, decedent, died testate on February 28, 1982. At the time of her death, she was a resident of Jacksonville, Duval County, Florida. Plaintiff is the Estate of Edna Sproull Williams, acting by and through James W. Burke as its personal representative.

Decedent executed her last will and testament on October 9,

1979, and a codicil to that will on October 25, 1979. Article I of decedent's will states in pertinent part:

> I DIRECT THAT ALL MY JUST DEBTS,INCLUDING EXPENSES OF MY LAST ILLNESS AND FUNERAL EXPENSES BE PAID BY MY PERSONAL REPRESENTATIVES AS SOON AS REASONABLY CONVENIENT AFTER MY DEATH. I DIRECT THAT ALL ESTATE, INHERITANCE AND SUCCESSION TAXES THAT MAY BE LEVIED AGAINST MY ESTATE, INCLUDING SUCH TAXES LEVIED AGAINST PROPERTY CONSTITUTING ANY PART OF MY ESTATE FOR FEDERAL ESTATE TAX PURPOSES, WHETHER PASSING UNDER THIS WILL OR OTHERWISE, SHALL BE PAID BY MY PERSONAL REPRESENTATIVES SOLELY OUT OF THE RESIDUARY ESTATE BEQUEATHED HEREUNDER, IT BEING MY INTENTION THAT THE PORTION OF MY ESTATE DEVISED AND BEQUEATHED TO OR FOR THE BENEFIT OF ALL LEGATEES, SHALL BE ENJOYED BY THEM FREE FROM ANY BURDEN FOR SUCH ESTATE, INHERITANCE OR SUCCESSION TAXES * * *.

With regard to the residue of her estate, decedent's will at Article XIII states in pertinent part:

> I GIVE, DEVISE AND BEQUEATH ALL OF

Appendix F

THE REST RESIDUE AND REMAINDER OF MY ESTATE, INCLUDING ALL LAPSED LEGACIES OR DEVISES, AFTER PAYING TEEREFROM ANY DEBTS AND TAXES, AND OTHER OBLIGATIONS OF MY ESTATE, INCLUDING ALL ADMINISTRATION EXPENSES, TO THE TRUSTEES OF THE EDNA SPROULL WILLIAMS FOUNDATION * * *.

The Edna Sproull Williams Foundation was created during decedent's lifetime under a Trust Agreement dated February 13, 1976 and is an organization exempt from taxation under section 501(c)(3).

On November 11, 1982, the personal representatives filed a Petition for the Construction of the Will of Decedent Edna Sproull Williams with the Probate Division of the Circuit Court of Duval County, Florida. In this petition, the representatives argued, *inter alia,* that although Article I of decedent's will mandates that estate taxes be paid out of the residuary estate, Article XIII implies no such mandate as to administration expenses and should be interpreted to mean that such expenses may be paid out of the residuary estate, at the discretion of the Personal Representatives, if not paid out of income.

On November 12, 1982 the Circuit Court of Duval County, Florida issued an order stating that Articles I and XIII of decedent's will are construed to authorize payment of administration expenses by the personal representatives out of income if they choose to do so and if they choose not to pay administration costs out of income, such expenses shall be paid out of the residual estate.

Appendix F

On November 24, 1982, the personal representatives filed the U.S. Estate Tax Return for the Estate of Edna Sproull Williams. The estate tax return reported a total gross estate of $10,489,753.94 and total deductions of $9,747,444.42, leaving a net taxable estate of $742,309.52. Of the $9,747,444.42 in deductions on the estate tax return, $9,662,605.10 represented "Charitable, Public, and Similar Gifts and Bequests" to the Edna Sproull Williams Foundation. Of this amount, $8,869,080.10 represented the claimed charitable residuary bequest.

No deduction for administration expenses was taken from the gross estate. Instead of deducting the administration costs on the estate tax return, the personal representatives elected to deduct them on the estate's income tax return, filed April 5, 1983. The deduction claimed for administration expenses totalled $144,441. There is a dispute between the parties regarding the source from which the administration expenses were paid. Plaintiff contends these expenses were paid out of post-mortem income; defendant contends that plaintiff has not proven his factual contention that these expenses were paid out of post-mortem income and not from principal.

The Commissioner conducted an audit of the estate tax return and determined that the $144,441 of administration expenses should reduce the amount of the charitable bequest passing to the charitable foundation. As a result the charitable deduction claimed by the estate for the bequest of the residue to the Edna Sproull Williams Foundation was reduced by $236,536.38 (from $9,662,605.10 to $9,426,068.72) with a resulting tax deficiency of $80,110.87 (plus $30,606.13 interest). This amount was paid in full under protest on July 9, 1985.

On October 24, 1986, plaintiff filed a Claim for Refund, which

was disallowed on October 7, 1987. Plaintiff filed a complaint with this court on October 4, 1989.

In its motion for summary judgment, defendant contends that under the decedent's will and Florida law the administration expenses of the estate are pre-residue expenses. Plaintiff contends that the decedent's will does not mandate that administration expenses be paid out of pre-residue principal and that the residue of the estate was increased by paying administration expenses out of post-mortem income rather than from the principal of the estate. The sole issue for decision is whether the charitable bequest deduction claimed by the Estate of Edna Sproull Williams must be reduced by the amount of the administration expenses deducted from the estate's income tax returns.

OPINION

Summary Judgment Standards

Summary judgment is appropriate when there are no genuine issues of material fact in dispute and the moving party is entitled to judgment as a matter of law. RUSCC 56(c). Only disputes over material facts, or facts that might significantly affect the outcome of the suit under governing law, preclude an entry of judgment. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248 (1986). A dispute about a material fact is genuine if the evidence would permit a reasonable juror to return a verdict in favor of the nonmovant. *Id.* The moving party has the burden of establishing that there are no genuine material issues in dispute and that the movant is entitled to judgment as a matter of law. *Celotex Corp. v. Catrett*, 477 U.S. 317, 322-23 (1986). A nonmoving party has the burden of providing sufficient evidence, not necessarily admissible at trial, to show that a genuine issue of material fact

indeed exists as to an essential element of its case with respect to which it has the burden of proof. *Celotex*, 477 U.S. at 322-24. In resolving the motion, the court cannot weigh the evidence and determine the truth of the matter on summary judgment. *Anderson*, 477 U.S. at 249, 255. Any evidence presented by the opponent is to be believed, and all justifiable inferences are to be drawn in its favor. *Id.* at 255.

Deductibility of Administration Expenses

I.R.C. § 2001(a) imposes an estate tax on the transfer of the taxable estate of every decedent who is a citizen of the United States. The taxable estate is equal to the gross estate less certain deductions permitted under I.R.C. §§ 2053-2056.

In general, § 2055 allows an estate a deduction for the amount of all bequests to charity to the extent that the transferred property is required to be included in the gross estate. The estate is entitled to deduct only the amount actually passing to the charitable beneficiary.[1] *Estate of Edyth Bush v. United States*, 223 Ct. Cl. 161, 618 F.2d 741 (1980); *Harrison v. Northern Trust Co.*, 317 U.S. 476, 480 (1943). Plaintiff bears the burden of showing a right to the claimed deduction. *Interstate Transit Lines v. Commissioner*, 319 U.S. 590, 593 (1943).

The decedent's estate realized a total income for the period ending December 31, 1982 in the amount of $434,515. Income received by an estate during its administration (post-mortem income) is not part of the gross estate of the decedent for estate tax

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1. I.R.C. § 2055(d) limits the amount of the charitable deduction: "The amount of the deduction under this section for any transfer shall not exceed the value of the transferred property required to be included in the gross estate."

purposes and is not taxable as such. *Bowes v. United States,* 593 F.2d 272, 275 (7th Cir. 1979); *Connecticut Bank & Trust Co. v. United States,* 465 F.2d 760, 764-65 (2d Cir. 1972); *Alston v. United States,* 349 F.2d 87, 88-89 (5th Cir. 1965). Instead, post-mortem income is taxable to the estate itself as income. I.R.C. § 641(a)(3). Because it is not includable in the gross estate, post-mortem estate income may not be used to increase the charitable deduction. *Bowes v. United States,* 593 F.2d 272, 275 (7th Cir. 1979).

Accepting plaintiff's position, for the purpose of these dispositive motions that the administration expenses were paid out of post-mortem income in order not to decrease the residue of the estate going to the charitable foundation, does not change the fact that the consequence of such action was to increase the amount of the charitable deduction. If administration expenses were paid from pre-residue estate assets, the residue and the charitable deductions would be reduced by that amount. Thus, post-mortem income was indirectly used to increase the charitable deduction by the amount of the administration expenses.

Generally, the residue of an estate is defined as that which remains after the payment of charges, debts and bequests. *See, e.g., Estate of Edyth Bush v. United States, supra,* 223 Ct. Cl. at 169, 618 F.2d at 745. The devolution of property in the estate and, thus, the amount of the residue remaining and qualifying for the charitable deduction is a question of state law. *Riggs v. Del Drago,* 317 U.S. 95 (1942); *Harris v. United States*, 370 F.2d 887, 893 (4th Cir. 1966); *Estate of Short v. Commissioner,* 68 T.C. 184, 190 1977). In the instant case, FLORIDA STAT. ANN., § 738.05(1) (WEST 1979), provides in pertinent part:

UNLESS THE WILL OTHERWISE

Appendix F

> PROVIDES * * * ALL EXPENSES INCURRED IN CONNECTION WITH THE SETTLEMENT OF A DECEDENT'S ESTATE, INCLUDING DEBTS, FUNERAL EXPENSES, ESTATE AND OTHER DEATH TAXES, INTEREST AND PENALTIES CONCERNING SUCH TAXES, FAMILY ALLOWANCES, FEES OF ATTORNEYS AND PERSONAL REPRESENTATIVES, AND COURT COSTS SHALL BE CHARGED AGAINST THE PRINCIPAL OF THE ESTATE.

In the instant case, there is no conflict between the Florida statute and the testator's will because the will did, in fact, provide for the payment of administration expenses out of pre-residue principal. Article XIII of the will stated:

> I GIVE, DEVISE AND BEQUEATH ALL OF THE *REST RESIDUE AND REMAINDER OF MY ESTATE*, INCLUDING ALL LAPSED LEGACIES OR DEVISES, *AFTER PAYING THEREFROM ANY DEBTS AND TAXES, AND OTHER OBLIGATIONS OF MY ESTATE, INCLUDING ALL ADMINISTRATION EXPENSES*, TO THE TRUSTEES OF THE EDNA SPROULL WILLIAMS FOUNDATION.

(Emphasis added.)

The plain language of Article XIII indicates that the testator intended that the administration expenses be paid out of the residue

of her estate. A different interpretation may not be given to the words expressed in a will unless there is an ambiguity or unless a contrary intention clearly appears. A court must assume that the testatrix meant what she said in the will. *See, e.g., Floyd v. Smith,* 59 Fla. 485, 51 So. 537 (1910); *Lowrimore v. First Savings & Trust Co. of Tampa,* 102 Fla. 740, 140 So. 887, 891 (1931); *Mosgrove v. Mach,* 133 Fla. 459, 182 So. 786 (1938). Here, there is no ambiguity or uncertainty obscuring the intent of the testatrix. Reading Articles I and XIII together, it is apparent that she bequeathed the residue of her estate to the Foundation free of any debts, taxes or other obligations. To this aim, she provided all debts, taxes and obligations, including administration expenses, be paid out of the principal of her estate before the remainder was transferred to the charitable foundation.

Throughout a series of cases beginning with *Waldrop v. United States,* 133 Ct. Cl. 902, 137 F.Supp. 753 (1956), the federal courts have read the estate laws as requiring that taxes and administration expenses charged against a charitable residual legacy must be deducted in full from the amount of the legacy at death in computing the charitable deduction. The Fifth Circuit decision in *Alston v. United States,* 349 F.2d 87 (5th Cir. 1965), is directly on point. In *Alston,* the decedent, by his will, after certain specific bequests to nieces and nephews, left the residue of his estate to a qualified charitable foundation. Unlike decedent's will in the instant case, the will in *Alston* did not specify the source from which the testator's debts and expenses must be paid. The estate's executor's elected to deduct certain administration expenses on the estate's income tax return. The amount claimed as a charitable deduction was not reduced by these administration expenses deducted on the income tax return. The Commissioner asserted an estate tax deficiency based on the failure to deduct these administration expenses from the gross estate in computing the residue.

Appendix F

The Fifth Circuit looked to Georgia law which provided that, unless otherwise directed by the will, the debts of the testator including the expenses of administration should be paid out of the residue of the estate. *Alston v. United States, supra,* 349 F.2d at 89. The taxpayers in *Alston* argued that if the administration expenses are paid out of post-mortem income rather than the estate's corpus, the residue passing to the charitable foundation is not decreased by said expenses. *Id.* In support of this argument, the taxpayers cited two cases, *Estate of Luehrmann,* 287 F.2d 10 (8th Cir. 1961) and *Republic National Bank of Dallas v. Commissioner,* 334 F.2d 348 (5th Cir. 1964). However, the court in *Alston* found that in neither of these cases was the question reached, since in each case the court found no proof that the administration expenses in issue had in fact been paid from income.

In holding for the Commissioner that administration expenses were pre-residue, the court based its decision on the clear language of the Georgia statute cited above and related Georgia decisions. 349 F.2d at 90. The reasoning of the *Alston* case has been followed by other courts considering the same issue. *See, Rifkind v. United States,* 5 Cl. Ct. 362, 373-74 (1984); *Estate of Horn v. Commissioner,* 91 T.C. 100 (1988); Rev. Rul. 73-98, 1973-1 Cum. Bull. 407; Rev. Rul. 82-6, 1982-1 Cum. Bull. 137.

In its cross-motion, plaintiff notes the decision of the Florida Circuit Court, which found that Article I and Article XIII of decedent's will can be construed to authorize payment of administration expenses out of post-mortem income or out of pre-residue principal, at the choice of the personal representatives. However, as plaintiff correctly points out, this court is not bound by the judgment of the Florida Circuit Court. That court is not the highest court of the state of Florida. *Commissioner v. Estate of Bosch,* 387 U.S. 456, 465 (1967); *Estate of Harmon v. Commissioner,* 84 T.C. 329, 333 (1985).

Appendix F

It is clear that under the Florida statute and under the terms of decedent's will, the administration costs are to be charged against the principal of the estate. This reduces that amount of the residue to be received by the charitable foundation under decedent's will. Therefore, the estate's charitable deduction must also be reduced by the amount of the administration expenses. *Harrison v. Northern Trust Co., supra,* 317 U.S. at 480.

The emphasis that plaintiff places on the payment of administration expenses from post-mortem income instead of principal is misplaced. The fact remains that 1) post-mortem income cannot be used to increase the amount of a charitable residual legacy, even by indirectly increasing the amount in the residual bequest; and 2) under both Florida state law and the unambiguous terms of decedent's will, these expenses should have been paid out of preresidue principal. Any increase in the amount of the residue passing to charity as a result of the use of estate post-mortem income to pay administration expenses cannot be included in the charitable deduction.

Accordingly, for all the foregoing reasons, the defendant is entitled to judgment as a matter of law. Therefore, it is ORDERED that defendant's motion for summary judgment is hereby granted, plaintiff's cross-motion for summary judgment is denied, and final judgment shall be entered dismissing the complaint with no costs to be assessed.

s/ James F. Merow
James F. Merow
Judge

APPENDIX G — INTERNAL REVENUE CODE SECTION 2055(a)

SEC. 2055. TRANSFERS FOR PUBLIC, CHARITABLE, AND RELIGIOUS USES.

[Sec. 2055(a)]

(a) In General. — For purposes of the tax imposed by section 2001, the value of the taxable estate shall be determined by deducting from the value of the gross estate the amount of all bequests, legacies, devises, or transfers —

(1) to or for the use of the United States, any State, any political subdivision thereof, or the District of Columbia, for exclusively public purposes;

(2) to or for the use of any corporation organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, including the encouragement of art, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), and the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual, which is not disqualified for tax exemption under section 501(c)(3) by reason of attempting to influence legislation, and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office;

(3) to a trustee or trustees, or a fraternal society, order, or association operating under the lodge system,

but only if such contributions or gifts are to be used by such trustee or trustees, or by such fraternal society, order, or association, exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, such trust, fraternal society, order, or association would not be disqualified for tax exemption under section 510(c)(3) by reason of attempting to influence legislation, and such trustee or trustees, or such fraternal society, order or association, does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office; or

(4) to or for the use of any veterans' organization incorporated by Act of Congress, or of its departments or local chapters or posts, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

For purposes of this subsection, the complete termination before the date prescribed for the filing of the estate tax return of a power to consume, invade, or appropriate property for the benefit of an individual before such power has been exercised by reason of the death of such individual or for any other reason shall be considered and deemed to be a qualified disclaimer with the same full force and effect as though he had filed such qualified disclaimer. Rules similar to the rules of section 501(j) shall apply for purposes of paragraph (2).